POLICY ANALYSIS

Why and how the energy subsidy in Indonesia should be reduced

Muhamad Rosyid Jazuli[1] | 24 February 2020

ABSTRACT
Having surfaced many times, issues of energy subsidy reduction have been a problem for every administration and have resulted in diverse political and social outcomes. Stakeholders keep on debating about what should have been done and should be done. This brief explains the challenges faced by the current policies and later provides reform policy recommendations to tackle the challenges. It contends that with careful measures, such as being undertaken with good social safety nets, Indonesia's reform policy package would arguably soften the adverse impacts of energy subsidy cuts on many Indonesians' lives, especially those of the unfortunate. If well applied, the measures could protect them from the increasing energy prices and even potentially free them from poverty.

With some careful considerations, Indonesia's subsidy reform policies will arguably soften the adverse impacts of energy subsidy cuts on many Indonesians' lives, especially those of the unfortunate. If well applied, the policies could protect them from the increasing energy prices and even potentially free them from poverty. This piece explains the challenges faced by current Indonesia's subsidy reform policies and also provides reform policy recommendations to tackle the challenges.

Energy subsidy cuts lead to higher fuel prices and have been substantially problematic in Indonesia. Having surfaced many times, the issues have been a problem for every administration and have resulted in diverse political and social outcomes ranging from debates and a regime change. Debates among stakeholders about what should have been done and what should be done happen more often. This issue brief explains the challenges faced by the current policies and later provides reform policy recommendations to tackle the challenges.

Indonesia's energy subsidy is quite generous, but recently it has gradually been reduced from, say in 2017, more than 20 percent in 2014 (IDR341 trillion) to less than

[1] Researcher at Paramadina Public Policy Institute. rosyid@policy.paramadina.ac.id

10 percent of the 2016 government budget (IDR102 trillion). The policy of reducing energy subsidy has been the focus of the current administration under President Joko "Jokowi" Widodo, along with their effort to increase the development budget. During his administration, fuel prices have changed at least six times. The government decided that energy prices, specifically the fuel prices, will be periodically adjusted every three months, depending upon the changing global energy prices. The administration claims that it has diverted the funds away to development areas such as education, health care, and infrastructure.

Many disagree with that decision, stating that the subsidy should not be reduced as it allows the poor to meet their daily needs by keeping necessities' prices low. The subsidy has not been proportionately benefiting many of the poorest in Indonesia. The World Bank records that around 40 percent of the total subsidy benefits the top 10 percent richest households and only 1 percent of it benefits the 10 percent poorest (Diop, 2014).

THE BACKGROUND AND CONTESTED VIEWPOINTS ABOUT ENERGY SUBSIDY IN INDONESIA

Issues about energy subsidy and prices in Indonesia have been igniting violent strikes. One of them brought the long dictatorship of President Suharto to an end in 1998, after fuel prices skyrocketed around up to 71 percent following the energy subsidy cut in the aftermath of the 1997 Asian financial crisis. Since then, there have been about 20 changes to the energy subsidy. The most significant change happened during President Yudhoyono's first term (2005-2009), when the subsidy cut raised fuel prices for more than 200 percent. Decisions to cut the subsidy are all for additional development budget, which is necessary for funding infrastructure projects.

However, even though the economic consideration of the energy subsidy is sound, it politically hardly sells. This situation is problematic as government leaders are responsible for the development with a limited budget. At the same time, they are political leaders who rely upon votes. People's political preferences play a significant role in making those leaders stay in power. For Indonesia, lower energy prices mean higher prospective votes.

Increasing the subsidy will be the most wanted option by the public as prices are low for almost everything that meets their basic needs, such as food and transportation. Relatively affordable energy prices will deter the increasing food prices that base the calculation partly on transportation costs. Energy price hikes often soon result in high inflation haunting tens of millions of poor Indonesians living below the poverty line representing 11.25 percent of the total population (as of March 2014). For example, the fuel price hike in 2005 pushed inflation to around 16 percent in 12 months and 2008 to approximately 11 percent in about 8 months (Bank Indonesia, 2016).

In practice, however, the subsidy reduces the country's fiscal space. This condition leads to stagnant development leaving the country at risk before the changing context of the global economic environment, given its poor economic performance lately following the 2008 global financial crisis. Thus, cutting the subsidy and increasing energy prices are highly necessary. Development is a priority for Indonesia to step up the global supply chain. For example, The Strait Times (2014) reports that the subsidy cut of 193 trillion rupiahs in late 2014 could fund investments in 5,500 new public hospitals, 39,000 new railway carriages, and 48,000 new public schools.

The energy subsidy has forgone the golden opportunity to enhance social protection and improve infrastructure development. The World Bank (2013) records that under-investment in infrastructure, primarily in transportation, will let go of every one percent of additional economic growth. In that sense, the current subsidy cuts policy should remain a priority. Phasing out the energy subsidies will boost Indonesia's spending on infrastructure and social programs that will grow Indonesia's economy significantly.

Regarding the challenging views of the subsidy cuts, reform policy options are needed to tackle these challenges. The following policy frameworks will offer implementable actions that could mitigate the negative exposure of subsidy cuts toward economic and political changes. These actions include:

ALTERNATIVE REFORM POLICIES

1. The price ceiling for the changing energy prices

The current policy has set energy prices to change based upon global prices periodically, reflected by the 6-time changes that have happened in the current administration era. However, the policy does not set a price limit for potential changes in the future. A price ceiling based upon rigorous risk analysis of global price changes and the public's purchasing power is necessary to be set to make sure that the highest price is capped to limit certain risk regarding the volatile global price (Diop, 2014: 5).

Otherwise, the public will be left with risky exposure to unpredictable abrupt price changes that would adversely impact other prices: food and transportation. Going forward, the strategy ensures that at a certain period of time, it finally cuts the whole energy subsidy, for example in 10 years, when the people are ready. This point leads us to the second recommendation.

2. Further price control and enhancement for social safety net

Energy price changes certainly affect other prices such as transport and food. Energy price hikes surely ignite higher inflation. Fortunately, the government has adopted temporary unconditional cash transfers to the poor that has been proven to be able to soften the impacts. However, it is notorious that when energy prices remain the same or decrease, transport and food prices just keep increasing. Thus, a strategic policy for price control is needed.

The policy should enable related agencies such as Coordinating Ministry for Economic Affairs, Ministry of Energy, Ministry of Transport, Ministry of Finance, and also related local government agencies to control the price. Business players, including SMEs, who abruptly increase the prices of their products should be warned or even punished. Furthermore, additional compensations should be formulated and manifested into better and more affordable healthcare and education services, community development, business opportunities, and social security programs in the pursuit of a stronger and safer social safety net.

3. Strategic communication plan

Regarding the energy prices hike announcement, the public will have diverse responses but mostly disagree with it. Some will even go on strike. This risk could be mitigated if there is a comprehensive strategic communication plan that covers pre, during and post price changes. In the pre-phase, initial campaigns and context conditioning are a priority. Programs such as public dialogues should let the public be initially aware and well-informed of the reasons behind and the impacts of subsidy cut. During the announcement, the public is more ready for the price change.

In the post phase, updates on the impacts should be informed to the public. Programs such as public seminars and dialogues with key stakeholders would beneficial to keep information balanced about the strengths and weaknesses of the price change. This strategy will work even better if the process is executed during particular moments. For example, raising prices during national or international festivals or holidays could alleviate the negative perception of the energy price hike impacts since the public does not put too much focus on the change, but the festivity and the joy of the celebration.

THE EVALUATION CRITERIA OF THE REFORM POLICIES' OUTCOMES

These reform policy recommendations will not succeed unless certain considerations are taken into account to evaluate their viability. They include:

1. Economic concerns: price, trade and investment competitiveness, and production levels

From the economic perspective, gradual changes in energy prices would let the people also be gradually prepared as their purchasing power will better off. Domestically, gradual change is good for people's readiness as the poor and vulnerable will have less exposure to the risk of inflation as basic necessities' prices increase gradually under control and backed by the enhanced social safety net. Internationally, Indonesia will have better trade and investment competitiveness that stems from lower business costs and better infrastructures.

Thus, production levels will not decrease as costs of production especially for logistics are stabilized. Furthermore, through its strategic communication plan and the right moment of the price changes, people will not feel too adversely impacted by the change. The communication plan will trigger actions from the people to enhance their economic well-being by initiating community development programs on their own, apart from programs initiated by the government.

2. Social considerations: income distribution, employment, and living standards

Regarding the social aspect, gradual energy price changes would lessen the potential of a widening gap of inequality of income distribution as the gradual change will ensure that the vulnerable have enough time to adjust to the price change. It also allows other options apart from the reform policies to take place including efforts to improve skills for workers through various training and to avoid layoffs for business owners by adjusting business models to the changing business context in regard to the price change. These endeavors will also be enhanced by various government social safety nets enhancement programs such as better public training and education and healthcare services.

Furthermore, if those strategies are well performed, instead of falling off deeper into poverty, people enjoy their higher living standards. This is also strengthened by a government communication plan so that those affected by the price change will not perceive that as a nightmare, but as an ample opportunity to let local people and businesses step up the global supply chain.

OTHER IMPORTANT FACTORS RELATED TO IMPLEMENTING REFORM POLICIES

Regarding the impact of the subsidy cut, it is important to consider a few other aspects to cushion the prospective adverse impact and to smoothen the implementation of the policy. These aspects are crucial to ensure the sustainability of the implementation. Firstly, political consideration has been playing an important role in any policy application in the country. Often policies are postponed or even canceled because of conflicting political agendas and interests. Thus, political conduciveness should be continuously established by lobbying and compromises among political leaders.

Secondly, one of the most challenging situations policy stakeholders in Indonesia have become aware of is regulatory uncertainty stemming from overlapping responsibilities across different departments. Thus, it is imperative to establish synergy and coordination among related key departments to implement the policy, such as Coordinating Ministry for Economic Affairs, Ministry of Energy, Ministry of Transport, Ministry of Finance, and local governments. Inter-departmental coordination is needed to ensure that every related department or agency works hand in hand in implementing the reform policies.

Lastly, it is crucial to have strong backing policies such as fiscal and monetary policies. The former can be reflected through tax-free policy for start-up businesses. There also must be other supporting programs such as free or affordable business training for new entrepreneurs. The latter policy, additionally, will widen the opportunities for those business players to grow by providing particular low-interest loans that let them have a wider and stronger foundation for running their businesses.

Those above considerations should be considered to ensure that the reforms are applicable. With vast income inequality, Indonesia is prone to social crisis anytime an economic crisis hits. The reform policies, along with those considerations, would surely soften the adverse impact of the energy subsidy cuts and the increasing energy prices and, at the same time, protect the poor and gradually free them from poverty. (*)

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Jl. Gatot Subroto Kav. 97, Mampang Prapatan,
Jakarta Selatan, DKI Jakarta 12790,
T + 62 21 79181188,
F: + 62 21 79181188
info@policy.aramadina.ac.id
https://policy.paramadina.ac.id/